

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Alternative Investments – Scope of Study
For Underserved Urban and Rural Communities

ITEM NUMBER: 5
ATTACHMENT(S): 1

ACTION: X

DATE OF MEETING: January 9, 2001

INFORMATION: _____

PRESENTER(S): Real Desrochers

One of the 2000/01 Alternative Investment objectives is for staff to explore the feasibility and potential benefits of private equity investments in under served urban and rural communities. At the October 11, 2000 meeting, the Investment Committee directed Staff and Pathway Capital Management to continue their developmental work on the scope of study with an independent consultant to fulfill this objective. As a result of that discussion, Staff and Pathway Capital Management have prepared the proposed scope of such a study, which is presented for the Committee's consideration as Attachment 1.

Staff and Pathway Capital Management recommend approval of the attached project scope. Upon approval of the scope, Staff will issue a request for proposal for an independent consultant to provide the required services.

ALTERNATIVE INVESTMENTS OBJECTIVES:

EXPLORE THE FEASIBILITY AND POTENTIAL BENEFITS OF PRIVATE EQUITY INVESTMENTS IN UNDERSERVED URBAN AND RURAL COMMUNITIES

Task	Responsibility	Due Date
I. BENEFITS Study the possible universe of private equity investment opportunities serving underserved urban and rural communities within California and the merits of such investing. What types of financing are required? (i.e. private equity, mezzanine debt, or debt?)	Consultant	
II. RISKS AND RISK ADJUSTED RETURNS <ul style="list-style-type: none"> ➤ What are the uniqueness and differences in these markets? To what extent are these markets pursued by institutional investors, including large pension funds? ➤ Can a large pension fund find an attractive private equity niche in underserved urban and rural environments with a reasonable risk/reward ratio? 	Consultant	
III. PRIVATE EQUITY INVESTMENTS HAVE THE FOLLOWING CHARACTERISTICS <ul style="list-style-type: none"> ➤ Can a large public pension fund expect to find some or all of these characteristics in underserved urban and rural private equity investing? <ul style="list-style-type: none"> ◆ Scalability – the investment must be able to grow at significant growth rates to generate economies of scale, barriers to easy competition, and high valuations. ◆ Liquidity (Exit) – the investments must be in sectors and have growth features that make them marketable to strategic or other financial buyers so that CalSTRS can exit them. ◆ Profitability – these investments should be able to generate returns consistent with the A.I. portfolio opportunity set over the long term. ◆ Capitalization – successful investments should have significant capitalizations to create the economic efficiencies of successful investments. 	Consultant	
IV. PRIVATE EQUITY IN UNDERSERVED URBAN AND RURAL ENVIRONMENT <ul style="list-style-type: none"> ➤ What are the unique opportunities within the underserved urban and rural markets? <ul style="list-style-type: none"> ◆ How large is the investment market opportunity within California and nationally? ◆ How are companies in the underserved markets currently funded, in terms of both equity and debt? Who provides the funding? ◆ In terms of capitalization, how large are the companies that could receive investment from a CalSTRS funded investment vehicle? Provide detail as to the number of companies at different capitalization sizes in the universe of possible investment opportunities. ◆ Is the opportunity set in these markets significant enough to create the returns required to offset the risks? How do the risks and rewards in the underserved urban and rural markets compare to other private equity markets? Would the risk/reward ratio improve with additional capital availability for the underserved urban and rural markets? ◆ What kinds of business sectors in the underserved urban and rural markets make good private equity investments, and which sectors stand a better chance of success? ◆ What kind of employees stand to benefit from opportunities, i.e., high skilled or low skilled? Will the subject markets benefit from high or low technology opportunities? 	Consultant	

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Task	Responsibility	Due Date
V. PARTICIPANTS IN THE PRIVATE EQUITY URBAN AND RURAL INVESTING <ul style="list-style-type: none">➤ What other institutional investors, including public pension funds, are investing in these markets? If no significant investing, why not?➤ Description of current programs➤ What are their performance track records and experiences in these markets?➤ What strategies and business models have been successful?	Consultant	
VI. CALSTRS' INVESTMENT OPTIONS <ul style="list-style-type: none">➤ Based on the successful strategies and business models described above, what are the options for CalSTRS?<ul style="list-style-type: none">◆ Partnerships◆ Co-investments◆ Direct Investments◆ Other	Pathway	
VII. RECOMMENDATIONS	Staff/Pathway	